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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935.

No. 226

MANHATTAN GENERAL EQUIPMENT COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

No. 227

COLLIER SERVICE CORPORATION, FORMERLY BROADWAY SUBWAY ADVERTISING CO., INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

LAURENCE GRAVES,
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Of Counsel.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935.

No. 226

No. 51,345 in the Circuit Court of Appeals.

MANHATTAN GENERAL EQUIPMENT COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

No. 227

No. 57,372 in the Circuit Court of Appeals.

COLLIER SERVICE CORPORATION, FORMERLY BROADWAY SUBWAY ADVERTISING CO., INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

MAY IT PLEASE THE COURT:

The petitioners, Manhattan General Equipment Company and Collier Service Corporation, by Laurence Graves, Esq., their attorney, pray that writs of certiorari issue to review

the judgments of the United States Circuit Court of Appeals for the Second Circuit (R. 84), affirming the orders of the United States Board of Tax Appeals (R. 53).*

A.

Summary Statement of Matter Involved.

The case was submitted upon an agreed statement of facts (R. 29-41), which may be summarized as follows:

Each of the petitioners was, during the years 1925 and 1926, one of a group of affiliated corporations, the gross income and deductions of which were included in consolidated income tax returns filed by the United Brokerage Company (R. 31).

On June 30, 1925, United Brokerage Company acquired at a cost of $3,414,345.63 the capital stock of Artemas Ward, Inc., a New York corporation, consisting of 4,964 shares of stock (R. 36). One of the assets of Artemas Ward, Inc., was a contract with the Interborough Rapid Transit Company controlling advertising and vending privileges in subways and elevated railways in the City of New York (R. 34, 36). This contract, which by its terms was to continue to December 31, 1928 (R. 34), was cancelled by the Transit Commission of the State of New York on November 1, 1925 (R. 36).*

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* The cases arise upon identical records, were argued together in the Circuit Court of Appeals and disposed of by that Court in a single opinion.

* For the year 1925 United Brokerage Company claimed as a loss to Artemas Ward, Inc., by reason of the cancellation of the Interborough contract, the difference between the March 1, 1913 value of the contract and deductions theretofore allowed Artemas Ward, Inc., in its tax returns for 1922, 1923, and 1924, on account of the exhaustion of the March 1, 1913 value of the contract. The Commissioner

On December 31, 1925, Artemas Ward, Inc., had net assets of a fair value of $1,246,920.07 (R. 37). On that date Artemas Ward, Inc., in pursuance of a plan of reorganization, transferred assets, subject to liabilities, having a net value of $961,952.86 to Artemas Ward, Inc., a Delaware corporation, in exchange for 100 shares of the stock of the Delaware corporation. On the same day, but after the transfer, Artemas Ward, Inc., the New York corporation, pursuant to the plan of reorganization distributed to United Brokerage Company the 100 shares of stock of the Delaware corporation together with accounts receivable amounting to $234,967.21. After this distribution the assets of

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of Internal Revenue disallowed the deduction sought for 1925. His decision was affirmed by the Board of Tax Appeals, and the latter affirmed by the Circuit Court of Appeals. The petitioners do not seek review of that determination. The sole issue presented concerns the tax for the next year, 1926.

Since, however, the question of the 1925 taxes is disposed of in the opinion of the Circuit Court of Appeals, the following brief statement of the issue there considered may help to delimit the present question: On March 13, 1922 Artemas Ward, an individual, transferred certain assets, including the Interborough contract, to Artemus Ward, Inc., in exchange for the latter's entire capital stock. Prior to that time Artemas Ward had been allowed in computing his net income to deduct certain amounts on account of the exhaustion of the March 1, 1913, value of the Interborough contract. These deductions, together with the deductions subsequently allowed to Artemas Ward, Inc., more than equalled the March 1, 1913, value of the contract. The Commissioner of Internal Revenue ruled that the acquisition of the contract by Artemas Ward, Inc., having been a nontaxable transaction, the deductions allowed to the individual and to the corporation were both to be considered in determining the unexhausted basis of the contract to Artemas Ward, Inc.

Artemas Ward, Inc., the New York corporation, consisted of $50,000 cash (R. 37). In December 1926 United Brokerage Company sold to an outside party for $49,640 the 4,964 shares of the stock of Artemas Ward, Inc., the New York corporation (R. 37, 38).

United Brokerage Company paid for the stock of Artemas Ward, Inc., the New York corporation (R. 36)	$3,414,345.63
By sale or other disposition, it received for its investment an aggregate of	$1,246,560.07
made up as follows (R. 37):	
(a) stock of Artemas Ward, Inc., the Delaware corporation, having a value when received of	$ 961,952.86
(b) accounts receivable to Artemas Ward, Inc., the New York corporation, aggregating	234,967.21
(c) from the sale of the stock of Artemas Ward, Inc., the New York corporation	49,640.00
	$1,246,560.07
Thus, United Brokerage Company suffered an actual loss upon its investment of	$2,167,785.56

Upon the basis of these transactions the petitioners claim that a deduction of $2,167,785.56 should properly be allowed to United Brokerage Company for 1926. The Commissioner of Internal Revenue in re-computing the tax for 1926 allowed a deductible loss of only $495,696.76 and determined deficiencies for 1926 accordingly.

It is not questioned that the reorganization when consummated was a non-taxable transaction under the provisions of Section 203 (c) of the Revenue Act of 1924, which section was reenacted into the Revenue Act of 1926 without change. The only issue in the case relates to the basis to

be given to the stock of Artemas Ward, Inc., the New York corporation, in December 1926, when it was sold by the United Brokerage Company.

Section 204 (a) (9) of the Revenue Act of 1926, a reenactment without change of that section of the Revenue Act of 1924, provides that for the purpose of determining the basis of the old and the new stocks in such a reorganization as was here consummated, the cost of the old stock shall be apportioned between the old and new stocks "under rules and regulations prescribed by the Commissioner with the approval of the Secretary." Pursuant to such authority, the Commissioner on October 6, 1924, promulgated Article 1599(2) of Regulations 65 prescribing the basis of apportionment applicable to reorganizations under Section 204(a) (9) of the Revenue Act of 1924. Article 1599(2) was again promulgated with immaterial changes on August 28, 1926, under Regulations 69 issued pursuant to the Revenue Act of 1926. Under Article 1599(2) as thus promulgated the cost of the stock of the old corporation was to be apportioned between its stock and the stock of the new corporation in the ratio of the value, upon the reorganization, of the old and new stocks, but with the proviso that in no event should the cost to be attributed to the new stock be greater than the value of the new stock at the time of the reorganization. Under this formula the cost to be attributed to the 100 shares of the stock of Artemas Ward, Inc., the Delaware corporation, was $961,952.86, its actual value.

On April 3, 1928, the Commissioner promulgated Treasury Decision 4144, which amended Article 1599(2) of Regulations 69 so as to eliminate the provision that the cost to be apportioned to the new stock should not exceed its value at the time of the reorganization. On November 13, 1929, the Commissioner of Internal Revenue promulgated Treasury Decision 4274 reaffirming the 1928 amendment of Ar-

ticle 1599(2) and extending its application to Regulations 65.*

Applying the amended Article 1599(2) retroactively, the Commissioner redetermined the cost to be apportioned to the stock of Artemas Ward, Inc., the Delaware corporation, at $2,634,041.66 (R. 39, 40). This resulted in reducing the cost apportioned to the stock of Artemas Ward, Inc., the New York corporation, to $780,303.97. Upon the readjusted basis of cost, the Commissioner determined the amount of the loss sustained by the United Brokerage Company upon the sale of the stock of the New York corporation to be $495,696.76 (R. 39, 40).

The Board of Tax Appeals approved the Commissioner's determination. The Circuit Court of Appeals, one of the judges dissenting, affirmed the Board of Tax Appeals and held that Article 1599(2) of the Regulations promulgated by the Commissioner pursuant to Section 204(a)(9) was tentative in character and that authority to amend the regulation retroactively was implied by Section 1008(a) of the Revenue Act of 1924 and 1108(a) of the Revenue Act of 1926. In so holding the Circuit Court of Appeals overruled the petitioners' contention that Article 1599(2) of the Regulations was legislative in character, that Section 1108(a) permitting non-retrospective amendment of interpretative regulations implies no authority to the Commissioner to amend legislative regulations retroactively, and that the Commissioner of Internal Revenue was without authority to amend and apply Article 1599(2) retroactively.

The question presented, therefore, is:

Where the Revenue Acts provide that the basis for ascertaining gain or loss with respect to stocks received or re-

* Decision 4274 also added certain matter, which concededly was declaratory of the interpretation previously given by the Commissioner to the unamended article, and which is immaterial here.

tained in a non-taxable reorganization shall be prescribed by the Commissioner of Internal Revenue under regulations to be promulgated by him, is the basis governed by a regulation promulgated by the Commissioner which is in effect at the time that a plan of reorganization is consummated and at the time that property is sold, or is it governed by a regulation prescribed by an amendment promulgated more than two years subsequent to those transactions?

More specifically, is Article 1599(2) of the Regulations promulgated by the Commissioner of Internal Revenue under the power granted by Section 204(a)(9) of the Revenue Act legislative in character, is authority to amend it retroactively to be implied from Sections 1008(a) and 1108(a), or, if such authority is not there implied, may the Commissioner nevertheless amend the regulation retroactively and apply it to completed transactions?

B.

Reasons Relied on for Granting the Writ.

The Circuit Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court. The Commissioner in promulgating the regulations under authority of Section 204(a)(9), in no sense merely interpreted the law. Prior to the issuance of his regulation there was no law providing for apportioning the cost between the stock originally held and the stock distributed pursuant to the plan of reorganization. Under the decision of this Court in *Arizona Grocery Company* v. *Atchison, Topeka & Santa Fe Ry. Co.*, 284 U. S. 370, the Commissioner must be held to have acted in a quasi-legislative manner in promulgating Article 1599(2). Under that decision of this Court the Commissioner was, therefore, without authority to amend retroactively the regulation

promulgated by him and acted upon by the petitioners. Whether or not Congress might have authorized the Commissioner to amend the regulations retroactively is not an issue in this case, since Congress has not done so. Hence the case of *Great Northern Railway Company* v. *Sunburst Oil and Refining Company,* 287 U. S. 358, upon which the majority of the Circuit Court of Appeals rested their decision, is inapplicable.

Ever since the enactment of the Revenue Act of 1924, and the continuance in subsequent acts, with minor changes, of elaborate, precise and comprehensive provisions governing the taxability upon the sale or other disposition of stock received or retained in connection with reorganizations, taxpayers and their counsel have acted and advised in reliance upon the plain propositions of Article 1599(2) promulgated under the authority of Section 204(a) 9). It was a matter of indifference to the petitioners' affiliate, the United Brokerage Company, in what proportions the assets of the New York corporation, whose stock it wholly owned, should be distributed between the New York and Delaware corporations under the plan of reorganization. If the Commissioner had promulgated in the first instance the regulation he sought to effect retroactively more than two years later, United Brokerage Company could have reduced the amount of the net assets transferred to the Delaware corporation, so that while such assets would have been more than ample for the latter's business needs, the proportion of assets transferred and retained would have been such as to permit substantially all of the loss to United Brokerage Company of $2,167,785.56 to be realized upon the sale of the stock of the New York corporation.*

The petitioners are not in the position of tax evaders. On the contrary, the Commissioner occupies the role of one

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* See detailed analysis, infra, pp. 19-21.

who has prescribed a "rule of the road" entirely fair and reasonable in its application to the petitioners and their affiliates and has then sought retroactively to change his ruling. Thus, although the United Brokerage Company could have proceeded safely and properly under the amended rule, the Commissioner seeks to penalize it for not having the prescience to anticipate that he would change his ruling in the particular in which Article 1599(2) was modified.

WHEREFORE your petitioners respectfully pray that writs of certiorari be issued out of and under the seal of this Honorable Court directed to the Circuit Court of Appeals for the Second Circuit, commanding that Court to certify and to send to this Court for its review and determination on a day certain to be therein named the full and complete transcripts of the records and all proceedings in the cases numbered and entitled on its docket "No. 51,345, *Manhattan General Equipment Company, Petitioner,* v. *Commissioner of Internal Revenue, Respondent*" and "No. 51,372 *Collier Service Corporation, Petitioner,* v. *Commissioner of Internal Revenue, Respondent,*" and that said judgments of the Circuit Court of Appeals for the Second Circuit may be reversed by this Honorable Court, and your petitioners may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioners will ever pray.

July 9, 1935.

MANHATTAN GENERAL EQUIPMENT COMPANY,
COLLIER SERVICE CORPORATION,
By LAURENCE GRAVES,
Attorney for Petitioners.

BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI.

I.

Opinions Below.

The opinion in the United States Board of Tax Appeals in *Manhattan General Equipment Co.* v. *Commissioner of Internal Revenue,* 29 B. T. A. 395 (R. 42); the opinion of the Circuit Court of Appeals for the Second Circuit is reported in *Manhattan General Equipment Co.* v. *The Commissioner of Internal Revenue,* 76 F. (2d) 892 (R. 69).

II.

Jurisdiction.

This Court has jurisdiction to review the judgments below under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925, 43 Stat. 938. The date of the judgment sought to be reviewed is April 22, 1935 (R. 54). On May 22, 1935 the Circuit Court of Appeals denied petitions for rehearing, without opinion (R. 88).

III.

Statutes and Regulations Involved.

These are set forth in the Appendix, *infra,* pp. 22-30.

IV.

Statement of the Case.

The facts of the case are fully stated in the accompanying petition for certiorari, at pp. 1-6.

V.

Specification of Errors.

1. The Circuit Court of Appeals erred in holding that the loss sustained by United Brokerage Company in 1926 upon

the sale of the stock of Artemas Ward, Inc. should be computed in accordance with the provisions of Article 1599(2) of Regulations 69, as amended and revised on April 3, 1928 and November 13, 1929.

2. The Circuit Court of Appeals erred in holding that authority of the Commissioner of Internal Revenue to amend retroactively the provisions of Article 1599(2) of Regulations 65 and 69 promulgated October 6, 1924 and August 28, 1926, respectively, may be implied from Section 1008(a) of the Revenue Act of 1924 and Section 1108(a) of the Revenue Act of 1926.

3. The Circuit Court of Appeals erred in failing to hold that the provisions of Article 1599(2) of Regulations 65 and 69 promulgated October 6, 1924 and August 28, 1926, respectively, were legislative in character and that the Commissioner of Internal Revenue was without power or authority to amend such provisions so as to apply retroactively to the petitioners.

4. The Circuit Court of Appeals erred in affirming the decision of the Board of Tax Appeals which sustained the Commissioner of Internal Revenue.

VI.

ARGUMENT.

A. Article 1599(2) of Regulations 65 and 69 promulgated by the Commissioner of Internal Revenue on October 6, 1924 and August 28, 1926, respectively, was legislative in character; and since

B. No implication may be drawn from Section 1008(a) of the Revenue Act of 1924 and Section 1108(a) of the Revenue Act of 1926, that the Commissioner of Internal Revenue is authorized to amend Article 1599(2) retroactively; hence

C. The basis for measuring the loss to petitioners' affiliate from the sale of the stock of Artemas Ward, Inc., is to be determined under Article 1599(2) as originally promulgated.

A.

Article 1599(2) of Regulations 65 and 69 promulgated by the Commissioner of Internal Revenue on October 6, 1924, and August 28, 1926, respectively, was legislative in character.

Section 203(c) of the Revenue Acts of 1924 and 1926 provides that if there is distributed to a shareholder in a corporation a party to a reorganization, stock in such corporation or in another corporation a party to the reorganization without the surrender of the stock originally held, no gain or loss to the shareholder shall be recognized. Section 204(a)(9) of these Acts provides, that in such a case, for the purpose of determining the gain or loss from a subsequent sale or other disposition, the basis of the old stock shall be apportioned between the old and the new stocks under regulations prescribed by the Commissioner of Internal Revenue. Until such regulations are prescribed there is no law in regard to the method to be used in apportioning the basis.

When the Commissioner acting pursuant to the power delegated to him under Section 204(a)(9) promulgates Article 1599(2) he is, we believe, in no sense interpreting the Revenue Act. Article 1599(2) does not purport to state the meaning of the Revenue Act. It is declarative of the law, and quasi-legislative in nature. In promulgating Article 1599(2) the Commissioner "speaks as the legislature" and his pronouncement "has the force of a statute". *Arizona Grocery Co.* v. *Atchison, Topeka & Santa Fe Railway Co.*, 284 U. S. 370, 386.

B.

No implication may be drawn from Section 1008(a) of the Revenue Act of 1924 or Section 1108(a) of the Revenue Act of 1926 that the Commissioner of Internal Revenue is authorized to amend Article 1599(2) retroactively.

Section 1108(a) of the Revenue Act of 1926, which is identical with Section 1008(a) of the Revenue Act of 1924 and Section 1314 of the Revenue Act of 1921, provides

> "In case a regulation or Treasury decision relating to the internal-revenue laws, made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect."

Under Section 605 of the Revenue Act of 1928, the Commissioner was given the same discretion without limitation as to how the change in his former ruling was occasioned. Under Section 506 of the Revenue Act of 1934, the 1928 provision was reiterated and extended to cover internal-revenue rulings as well as regulations and Treasury decisions.

The majority of the Circuit Court of Appeals held that since these sections of the Revenue Act authorized the Commissioner in his discretion to amend regulations without retroactive effect that the inference was to be drawn that, apart from these sections, the Commissioner would have been required upon amending his regulations to do so retroactively in all cases. The majority of the Circuit

Court of Appeals reasoned that the enactment of these Sections

> "shows that the Regulations of the Commissioner are to be regarded as tentative for the reason that amendments are retroactive unless stated to be otherwise."

Both the majority of the Circuit Court of Appeals and the dissenting judge, we believe, recognize that Article 1599 (2) was of such character as to preclude retroactive amendment under the decision of this Court in *Arizona Grocery Company* v. *Atchison, Topeka & Santa Fe Ry. Co.*, 284 U. S. 370, unless Congress had authorized the retroactive amendment. The majority of the Circuit Court of Appeals found that such authority was to be implied from Sections 1008 (a) of the Revenue Act of 1924 and Section 1108 (a) of the Revenue Act of 1926. The dissenting judge was of opinion that the discretion vested in the Commissioner by Sections 1008 (a) and 1108 (a) to apply without retroactive effect amendments to interpretative regulations afforded no basis for inferring discretion to apply with retroactive effect amendments to regulations legislative in character.

The interpretation given these sections by the dissenting judge is, it is submitted, fully supported by the Reports of the Committee of Congress. As was said by the Ways and Means Committee with reference to Section 1314 of the 1921 Revenue Bill,

> "This would facilitate the administration of the internal revenue laws, in that it would make it unnecessary to reopen thousands of settled cases." (H. Rep. No. 350, 67th Cong. 1st Sess. pp. 15, 16.)

In its report upon the Revenue Bill of 1928, the Senate Committee on Finance explaining Section 605 said that

> "The policy of this provision is highly desirable, and in view of the fact that the Bureau of Internal Revenue

> is now comparatively free from the congestion of cases from the war years, it is believed that this policy may now be extended to cases where the new regulation or Treasury decision is occasioned or required by a court decision." (S. Rep. No. 960, 70th Cong., 1st Sess. p. 40.)

Probably the clearest explanation of the purpose of these sections of the Revenue Acts is to be found in the identical statements in the House and Senate Reports and Section 506 of the Revenue Act of 1934, that

> "Regulations, Treasury Decisions, and rulings which are merely interpretive of the statute will normally have a universal application, but in some cases the applications of regulations, Treasury Decisions, and rulings to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury Decisions, and rulings with prospective effect only." (H. Rep. No. 704, p. 38, and S. Rep. No. 558, 73rd Cong., 2d Sess.)

The reports accompanying the 1934 legislation would seem particularly to recognize that only certain of the regulations promulgated by the Commissioner are "interpretive of the statute" and that only as to such regulations was it necessary to vest in the Commissioner authority to amend without retroactive effect. The amendment of regulations, legislative in character, would not, unless provided by law, have any retroactive effect, and it was therefore unnecessary for Congress to provide that with respect to such regulations the Commissioner might make with prospective effect only.

The purpose of these sections of the Revenue Acts as disclosed by the Committee reports, was to relieve the

Commissioner, upon revising an earlier interpretation of the Acts, from the necessity of applying the new interpretation to cases previously disposed of by him under his former ruling. They were intended to avoid the congestion of proceedings before the Commissioner which would have followed from a reexamination of all pending cases on the basis of the amended regulation.

It would seem strange that the enactment of legislation intended to save taxpayers from necessarily retroactive application of interpretive regulations should be held to indicate that the Commissioner may make all amendments retroactively without regard to whether the regulation amended was interpretive or legislative in character.

C.

The basis for measuring the loss to petitioners' affiliate from the sale of the stock of Artemas Ward, Inc., is to be determined under Article 1599(2) as originally promulgated.

The majority of the Circuit Court of Appeals support their decision that Article 1599 (2) as amended is determinative by reference to the decision of this Court in *Great Northern Railway Co.* v. *Sunburst Oil & Refining Co.*, 287 U. S. 358, and to the decision of the Circuit Court of Appeals for the Third Circuit, in *Titsworth* v. *Commissioner of Internal Revenue*, 73 F. (2d) 385. Neither decision, the petitioners claim, is applicable.

In the *Sunburst Oil & Refining Co.* case, this Court held that no constitutional right was violated by the Montana Railroad Commission Act which, as construed by the State supreme court, empowered the Board of Railroad Commissioners to declare provisional rates and thereafter to award

damages to a shipper upon finding that the rates so fixed were unreasonable. This Court said:

> "*Arizona Grocery Co.* v. *Atchison, T. & S. F. Ry. Co.*, 284 U. S. 370, holds nothing to the contrary. This Court in disposing of that case was not dealing with any question of constitutional law. It was construing a Federal statute. Congress had delegated to the Interstate Commerce Commission the power to fix rates and to revoke them. The holding was that the grant of power to revoke did not include by fair intendment a power to invalidate by relation the rates established in the past. The opinion of the court does not speak of the constitution, but plants itself upon the statute, and from that source and no other derives its energy." (278 U. S. at pp. 362, 363.)*

Similarly, Congress under Section 204 (a) (9) delegated to the Commissioner of Internal Revenue, the legislative authority to promulgate regulations necessary to complete the law with respect to the apportionment of the basis of stocks received or retained in a reorganization effected in accordance with Section 203 (c).

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* In the *Sunburst Oil & Refining Co.* case, the Montana Supreme Court held that it would follow its dictum in the earlier case of *Doney* v. *Northern Pacific Railway Co.*, 60 Mont. 209, 199 Pac. 432, since shippers in reliance on that decision might have delayed challenging rates by the Commission. It recognized, however, that the construction it had previously given the statute in the *Doney* case was not in harmony with the interpretation given by this Court to the Transportation Act in *Arizona Grocery Co.* v. *Atchison, Topeka & Santa Fe Railway Co., supra,* nor with the construction other State courts had given to railroad commission statutes. The Supreme Court of Montana held, therefore, that while the rule laid down in the *Doney* decision would be adhered to in cases arising out of shipments made prior to the decision in the instant case, it would not be applied to subsequent shipments.

There is no reason to believe that the power thus vested in the Commissioner "by fair intendment" vested in him the power retroactively to amend his legislative regulations. Authority for such unusual and startling power either by an administrative body or an administrative officer, unless found to have been expressly granted by Congress, should be denied.

In *Titsworth* v. *Commissioner of Internal Revenue*, *supra*, the Circuit Court of Appeals for the Third Circuit in sustaining the Commissioner of Internal Revenue found it unnecessary to determine whether the original regulation if reasonable in its application might have been amended retroactively. The court found that the later amendment was justified either because the original regulation was unreasonable in its application to the situation, or that the later amendment was simply interpretive of the original regulation. The court said:

> "Section 113 of the Revenue Act of 1928 (26 U. S. C. A. Sec. 2113) requires the Commissioner to set up rules to determine gain from the sale of stock acquired in tax-free distributions. It provides that the basis shall be apportioned, under regulations, between such stock and the stock distributed. The resulting regulations are more than an administrative understanding or opinion of the law. If they are reasonable, they must be a declaration of the law under the authority given by Congress. The regulations as amended do not impose a tax liability on a transaction already completed. The tax liability arises under section 113 (a) (9), and that statute imposes upon the Commissioner the duty of providing the means of computing the tax. Whether Regulation 74 was defective in not providing a proper method of spreading the basis of cost or not clear in defining the scope of its

application, we see no sound reason why the error should not be corrected.*

In the present case, it is agreed that Article 1599 (2) as originally promulgated was applicable to the reorganization of Artemas Ward, Inc., the New York corporation. The issue is whether Article 1599 (2) may be retroactively changed. Unlike the situation in the *Titsworth* case, Article 1599 (2) if applied in its original form would not effect an unreasonable result; on the contrary the application of the amended regulation would.

Under Article 1599 (2) as originally promulgated, petitioners' affiliate United Brokerage Company apportioned to the stock of the New York corporation such part of the original cost to it of the stock as to permit realization of the actual loss of $2,167,785.56 (*supra*, p. 4) on selling the stock. Under the amended regulation the deductible loss allowed is only $495,696.76 (R. 39, 40).

In all fairness United Brokerage Company should not now be held to the regulations as amended more than two years after the transactions occurred. For if the Commissioner had promulgated in the first instance the regulation he seeks to effect retroactively, the United Brokerage Company could have consummated the reorganization so as to have permitted it to realize upon the subsequent sale of the stock of the New York corporation substantially all of its actual loss. A consideration of the facts will easily and convincingly demonstrate this.

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* Section 113 (a) (9) of the Revenue Act of 1928 is a reenactment of Section 204 (a) (9) of the 1924 and 1926 Acts. Article 600 of Regulations 74 promulgated thereunder was identical with the unamended Article 1599 of Regulations 65 and 69. Its amendment was effected by Treasury decision 4274, November 13, 1929, which as previously indicated (*supra*, pp. 5-6), amended in like manner Article 1599 of Regulations 65 and 69.

At the time of the reorganization, the fair value of the net assets of the New York corporation amounted to $1,246,920.07 (R. 37). To have transferred to the new corporation net assets of the value of $50,000 would have resulted in the creation of an amply solvent corporation.*

Upon the transfer to the new corporation of net assets of $50,000, its stock would have had a value of four per cent of the total value of the stocks of the old and new corporations. Immediately after the reorganization the New York corporation would have had net assets of $1,196,920.07. Applying the regulations, as amended by the Commissioner more than two years later, the basis of the stock of the New York corporation for the purpose of determining the gain or loss upon its sale would have been 96 per cent of the $3,414,345.63, cost, or $3,167,785.56

United Brokerage Company could then, as in fact it actually did, have caused to be distributed to it all but $50,000 of the assets of the New York corporation. Since the latter corporation had sustained such an enormous loss during the short period which its stock had been owned by the United Brokerage Company, this distribution would have been non-taxable under Sections 201(b) and 201(h) of the Revenue Act of 1926.†

Thereafter, it may be assumed that, as it actually did, United Brokerage Company sold the stock of the New York corporation for $49,640. The result would have been the

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*Although not disclosed by the record, and hence not binding upon the Commissioner, the United Brokerage Company at the time of the reorganization, estimated that net assets of $30,000 would be ample to enable the new corporation to do business.

† These were reenactments of those sections of the Revenue Act of 1924, with the exception that 201(g) of the 1924 Act was renumbered 201(h) in the 1926 Act.

realization by United Brokerage Company of a deductible loss of $2,031,212.09 (only $136,573.47 less than the actual loss) as compared with the deductible loss of $495,696.76 to which the Commissioner now seeks to restrict the company.

We repeat that the petitioners are not in the position of tax evaders. It was to the petitioners' affiliate, the United Brokerage Company, a matter of indifference in what proportion the assets of the New York corporation, whose stock it wholly owned, should be distributed between the New York and Delaware corporations under the plan of reorganization. It has been misled by the rule prescribed by the Commissioner acting in a legislative capacity. His attempt retroactively to amend such a regulation is without precedent and we believe that the petitioners cannot fairly be penalized by permitting the exercise of such an authority for which no warrant is found in any Act of Congress.

Conclusion.

WHEREFORE, the petitioners respectfully submit that these are cases in which writs of certiorari should be issued to review the decisions of the Circuit Court of Appeals.

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July 9, 1935.

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EMIL WEITZNER,
Of Counsel.

APPENDIX.

Revenue Act of 1924, c. 234, 43 Stat. 254, 256, 259 and Revenue Act of 1926, c. 27, 44 Stat. 13, 14, 15:

Sec. 201. Distributions by Corporations.

(d) If any distribution (not in partial or complete liquidation) made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not out of earnings or profits, then the amount of such distribution shall be applied against and reduce the basis of the stock provided in section 204, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. The provisions of this paragraph shall also apply to distributions from depletion reserves based on the discovery value of mines.

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(g) As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

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Sec. 203. Recognition of Gain or Loss from Sales or Exchanges.

(c) If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

Sec. 204. Basis for Determining Gain or Loss, Depletion, and Depreciation.

(a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

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(9) If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in subdivision (c) of section 203, the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed.

Revenue Act of 1921, c. 136, 42 Stat. 314;

Sec. 1314. Retroactive Regulations.

That in case a regulation or Treasury decision relating to the internal-revenue laws made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect.

Revenue Act of 1924, c. 234, 43 Stat. 341 and Revenue Act of 1926, c. 27, 44 Stat. 114;

Sec. 1008.* Retroactive Regulations.

(a) In case a regulation or Treasury decision relating to the internal-revenue laws, made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or

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* Section 1008 of the Revenue Act of 1924 became Section 1108 of the Act of 1926 without further change.

Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect.

Revenue Act of 1928, c. 852, 45 Stat. 874.

Sec. 605. Retroactive Effect of Regulations or Treasury Decisions.

(a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect.

Revenue Act of 1934, c. 277, 48 Stat. 757:

Sec. 506. Retroactive Effect of Regulations or Treasury Decisions.

(a) The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

Regulations 65, Article 1599 (subdivisions 1 and 2), promulgated October 6, 1924:

Art. 1599. Dividend stock.—In the case of stock or securities acquired by a stockholder after December 31, 1923, in connection with a transaction described in article 1576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the stockholder. The basis for the old and new shares shall be determined in accordance with the following rules:

(1) Where the stock issued as a dividend is all of substantially the same character or preference as the stock upon which the dividend is paid, the basis of each share will be the quotient of the cost or other basis of the old shares of the stock divided by the total number of the old and new shares.

(2) Where the stock issued as a dividend is in whole or in part of a character or preference materially different from the stock upon which the dividend is paid, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are issued, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new preferred stock shall in no case exceed the fair market value of such shares as of the time of their issuance.

Regulations 69, Article 1599 (subdivisions 1 and 2), promulgated August 28, 1926:

Art. 1599. Stock or securities distributed in reorganization.—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 203(c) and article 1576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules:

(1) Where the stock distributed in reorganization is all of substantially the same character or preference as the stock in respect of which the distribution is made, the basis of each will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and new shares.

(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new stock shall in no case exceed the fair market value of such shares as of the time of their distribution.

Treasury Decision 4144, promulgated April 3, 1928, amending Article 1599 of Regulations 69, provided as follows:

Paragraph (2) of Article 1599 of Regulations 69 is hereby amended by striking out the last sentence thereof.

Treasury Decision 4274, promulgated November 13, 1929, amended Article 1599 of Regulations 69, as amended by Treasury Decision 4144, to read as follows (paragraphs (1) and (2):

Art. 1599. *Stock or securities distributed in reorganization*—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in Section 203 (c) and Article 1576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old shares and the new shares or securities shall be determined in accordance with the following rules:

(1) Where the stock distributed in reorganization consists solely of stock in the distributing corporation and is all of substantially the same character and preference as

the stock in respect of which the distribution is made, the basis of each share will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and new shares.

(2) Where the stock distributed in reorganization is in whole or in part stock in a corporation a party to the reorganization other than the distributing corporation, or where the stock distributed in reorganization is in whole or in part stock of a character or preference materially different from the stock in respect of which the distribution is made, or where the distribution consists wholly or partly of securities other than stock, the cost or other basis of the stock in respect of which the distribution is made shall be apportioned between such stock and the stock or securities distributed in proportion, as nearly as may be, to the respective values of each class of stock or security, old and new, at the time of such distribution, and the basis of each share of stock or unit of security will be the quotient of the cost or other basis of the class of stock or security with which such share or unit belongs, divided by the number of shares or units in the class. Within the meaning of the foregoing provision, securities are different in class from stocks, stocks or securities in one corporation are different in class from stocks or securities in another corporation, and, in general, any material difference in character or preference or terms sufficient to distinguish one stock or security from another stock or security so that different values may properly be assigned thereto, will constitute a difference in class.

Article 1599 of Regulations 65 was similarly amended by this Treasury Decision.

Revenue Bill of 1921.

House Report No. 350, Ways and Means Committee, 67th Congress, 1st Session, pp. 15, 16.

Title X.—Administrative Provisions.

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Section 1002* would permit the Treasury Department to apply without retroactive effect a new regulation or Treasury decision reversing a prior regulation or Treasury decision, unless such reversal is occasioned or required by a decision of a court of competent jurisdiction. This would facilitate the administration of the internal-revenue laws in that it would make it unnecessary to reopen thousands of settled cases.

Revenue Bill of 1928.

Senate Report No. 960, Committee on Finance, 70th Congress, 1st Session, p. 40.

Sec. 605. Retroactive Regulations.

Section 1108 (a) of the revenue act of 1926 provides that where a regulation or Treasury decision is reversed by a subsequent regulation or Treasury decision, the subsequent decision may be applied without retroactive effect if the reversal is not immediately occasioned or required by a court decision. The policy of this provision is highly desirable, and in view of the fact that the Bureau of Internal Revenue is now comparatively free from the congestion of cases from the war years, it is believed that this policy may now be extended to cases where the new regulation or Treasury decision is occasioned or required by a court

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*House Report 350 accompanied H. R. 8245. As indicated, Section 1002 of the Bill became, without further change, Section 1314 of the Revenue Act of 1921. See Senate Document No. 73, 67th Congress, 1st Session, p. 270.

decision. Fundamentally there is no difference in the two cases which can justify the restrictions in Section 1108 (a) of the 1926 act. Accordingly, these restrictions have been removed in Section 605 of the bill. It is believed that this amendment will prove a substantial step forward in the simplification of the administration of the internal revenue laws, especially the income tax.

Revenue Bill of 1934.

House Report No. 704, Ways and Means Committee, 73d Congress, 2d Session, p. 38.

Section 506. Retroactivity of rulings: This section amends Section 1108(a) of the Revenue Act of 1926, as amended, so as to permit the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the extent, if any, to which any regulation, Treasury Decision, or ruling relating to internal revenue taxes shall be applied without retroactive effect. The amendment extends the right granted by existing law to the Treasury Department to give regulations and Treasury Decisions amending prior regulations or Treasury Decisions prospective effect only, by allowing the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the exact extent to which any regulation or Treasury Decision, whether or not it amends a prior regulation or Treasury Decision, will be applied without retroactive effect. The amendment furthermore permits internal revenue rulings as well as regulations or Treasury Decisions to be applied without retroactive effect. Regulations, Treasury Decisions, and rulings which are merely interpretive of the statute will normally have a universal application, but in some cases the applications of regulations, Treasury Decisions, and rulings to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury Decisions, and rulings with prospective effect only.

Revenue Bill of 1934.

Senate Report No. 558, Committee on Finance, 73d Congress, 2d Session, p. 48.

Section 506. Retroactivity of Rulings.

This section amends Section 1108(a) of the Revenue Act of 1926, as amended, so as to permit the Secretary to prescribe the extent, if any, to which any regulation, Treasury Decision, or ruling relating to internal-revenue taxes shall be applied without retroactive effect. The amendment extends the right granted by existing law to the Treasury Department to give regulations and Treasury Decisions amending prior regulations or Treasury Decisions prospective effect only, by allowing the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the exact extent to which any regulation or Treasury Decision, whether or not it amends a prior regulation or Treasury Decision, will be applied without retroactive effect. The amendment furthermore permits internal-revenue rulings as well as regulations or Treasury Decisions to be applied without retroactive effect. Regulations, Treasury Decisions, and rulings which are merely interpretive of the statute, will normally have a universal application, but in some cases the application of regulations, Treasury Decisions, and rulings to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury Decisions, and rulings with prospective effect only. Your committee made only clerical changes in this section of the House bill.